

The
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Carson Block

Red-flag raises

The man behind Muddy Waters, a scourge of listed Chinese companies

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CARSON BLOCK isn't the obvious candidate to show up John Paulson, a hedge-fund star who oversees \$37 billion in assets. Mr Block is 35 years old. His previous business ventures include a Shanghai storage company called Love Box Self Storage. He co-authored a book called "Doing Business in China for Dummies". Muddy Waters Research, his latest firm, has been around for only 12 months.

Most people on Wall Street hadn't heard of him until last month, when he released a report accusing Sino-Forest, a Chinese forest-plantation operator listed in Canada, of overstating its timber holdings. Spooked investors sold the stock, which plunged by 78% in a matter of days, dealing Mr Paulson, Sino-Forest's largest shareholder, around \$110m in net losses after he dumped all his shares.

In the year since he founded Muddy Waters, Mr Block's name has become an alarm-bell for investors in Chinese companies. Including Sino-Forest, Muddy Waters has released reports on five firms. In each case the company's stock sank, and in some cases, like China MediaExpress Holdings, which sells advertising on Chinese buses, the companies were delisted.

Sino-Forest and China MediaExpress deny allegations of fraud; Rino International, a maker of environmental equipment, admitted it had falsified some of its contracts. But Patrick Chovanec of Tsinghua University says that denial and confession are almost incidental: "It's not that people concluded he's right about these companies. It's that they realised they don't know whether he's right or not."

Critics accuse Mr Block of fear-mongering and targeting firms for his own gain. Mr Block, who is earnest and surprisingly bright-eyed for someone who wars with corporate management for a living, insists he is trying to protect investors. He isn't a "ninja assassin", he says, beating up companies for the fun of it.

Ninja or not, he works to preserve his mystique. Mr Block divides his time between Hong Kong and America but doesn't like to disclose his location because he has received death threats. He refuses to share any details about his business model, including whether he has outside investors. "All people need to know is that I have a clear conflict of interest," he says, referring to the short positions he takes in the firms he researches.

Muddy Waters has no full-time employees except for Mr Block, and hires contractors to help with research. He probably sells subscriptions to his research reports to hedge funds so they can take short positions in the stocks Muddy Waters will target before he releases those reports to the public. But no one admits to knowing which funds are Mr Block's clients.



Whether his rise to stardom proves short-lived will depend largely on whether his allegations stand up. Sino-Forest, which vehemently denies the accuracy of Mr Block's claims, has commissioned an independent audit to be released within the next few months. Firms are becoming shrewder at fending off Mr Block's claims. After he wrote an open letter to Spreadtrum, a semiconductor company, questioning sales figures, management announced a dividend and share buybacks, which gave succour to anxious investors.

Competition is also a threat. More firms are betting against Chinese stocks, so it is becoming more expensive to borrow shares in target companies. Regulators are also trying harder to police Chinese companies listing in America, depriving short-sellers of potential opportunities. On July 11th and 12th American regulators are expected to meet their Chinese counterparts in Beijing to talk about whether they will be allowed to investigate Chinese firms.

Mr Block may have to wade into muddy waters elsewhere. Some think he may look to Hong Kong-listed companies. Mr Block says he may expand his research to other regions, like Latin America. Just don't expect him to disclose his whereabouts.

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